

VZCZCXYZ0007
PP RUEHWEB

DE RUEHGB #1802/01 1871211
ZNR UUUUU ZZH
P 061211Z JUL 09
FM AMEMBASSY BAGHDAD
TO RUEHC/SECSTATE WASHDC PRIORITY 3801
INFO RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS BAGHDAD 001802

SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [EAID](#) [IZ](#)

SUBJECT: RISING OIL PRICES IMPROVE IRAQ'S BUDGET OUTLOOK,
BUT GROWTH FORCASTED LOWER FOR 2009

REF: BAGHDAD 1764

¶1. (SBU) SUMMARY: Rising oil prices have improved Iraq's 2009 budget outlook, but they are not a panacea for all of the country's budget woes. Projected 2009 GOI revenues of \$42.7 billion are still optimistic since oil exports for the remainder of the year are likely to remain well below the forecast of two million barrels of exports per day. This will not necessarily translate into a higher deficit this year, since the delay in passing the 2009 budget led to the GOI to spend money very slowly during the first half of the year. That said, with national elections planned in January we expect to see much higher spending in the second half of 2009; PM Maliki has even suggested that higher oil prices may support a supplemental budget to increase spending. Based on current spending, which includes relatively low capital outlays, analysts predict growth will decrease by almost two points this year. A new Stand-By Arrangement with the IMF may be the key for the GOI to keep up its capital improvements this year and next while also saving its reserves for possibly rockier years ahead. END SUMMARY.

RISING OIL PRICES PROVIDE SOME RELIEF

¶2. (SBU) With the decline in the price of oil in late 2008 and earlier this year, the GOI's 2009 revenue projection of \$42.7 billion (based upon \$50 per barrel) looked overly optimistic. By the end of the first quarter, GOI revenue was 35% below its projected target because of export volume and price deficiencies. Since May 23, however, the price has remained above \$50 per barrel, decreasing the likelihood that the Minister of Finance will introduce a negative supplemental budget as was being discussed in the spring. This increase in oil revenue provides some budget relief, but it is not a panacea for all of Iraq's budget woes.

PRODUCTION PROJECTIONS WERE ALSO OPTIMISTIC

¶4. (SBU) Oil prices in their current \$70/barrel range are not sufficient to permit the GOI to meet this year's revenue forecast, given the continued lower-than-expected level of production. May exports of 1.9 million bpd was a record high for the year, but is still below the 2.0 mbpd forecast used in the 2009 budget. Further, industry experts claim that the May level is not sustainable and that 1.85 million bpd is a better estimate for average daily exports. (COMMENT: The GOI's June 30 oil-field bid-round resulted in a consortium led by BP winning rights to work Iraq's largest oil field, and included a promised production level that would increase Iraq's current oil production by 75% (Ref A). However, contract negotiations will take months to complete, and there will be a further lag as BP ramps up operations, meaning increased output from the June 30 decision is unlikely before ¶2011. A more immediate impact of June 30 is that the GOI will get a signing bonus from the one deal of \$500 million, although this is well short of the \$2.4 billion in total signing bonuses the GOI anticipated as a means to bolster

short-term revenues; assuming protracted contract negotiations, the GOI is not likely to see this income in 2009. END COMMENT.)

CAREFUL SPENDING IS STILL CRUCIAL

15. (SBU) On the spending side, the delay in passing this year's budget increases the chances that the GOI will not be able to fully execute its \$58.6 billion in budgeted expenditures before year's end. Under continuing resolution until mid-April when the budget passed, the GOI carefully limited all spending to necessary operating expenses. Qlimited all spending to necessary operating expenses. Through April, the GOI had only spent 15% of the budget, and nearly all of that was on operating expenses. The Ministry of Finance has also vowed not to authorize new spending by line ministries until they have demonstrated they have appropriately spent their previous allocation. If spending continues this conservatively, the year-end deficit could be less than the projected \$15.9 billion, even if revenues lag behind projections. On the other hand, with elections scheduled for the beginning of next year, GOI officials have a strong incentive to see projects completed and to delay any cuts in spending, especially in sensitive sectors or in specific geographical areas. Prime Minister Nouri al-Maliki has already announced in the press that higher oil prices could allow him to introduce a positive supplemental budget to finance specific projects.

CAPITAL IMPROVEMENTS MAY BE CUT, BUT ARE NECESSARY FOR GROWTH

16. (SBU) The GOI this year plans to devote \$45.9 billion to basic operating expenditures (which covers salaries, minimal power and maintenance, and essential services to keep the government going). This is an increase from the \$36.8 billion in actual operating expenses last year, but significantly less than what the GOI hoped to spend when planning began for the 2009 budget. On the investment side, the 2009 budget includes \$12.7 billion for capital improvements, down from \$13.1 actually spent in 2008. Lower-than-expected spending has led to reductions in growth forecasts: the Economist Intelligence Unit predicted in June 2009 that growth will decline from 7.8% to 5.7% for the year, mostly because of decreased government spending and deteriorating infrastructure. (COMMENT: The GOI maintains a 2009 growth estimate of 9.7% for 2009. This seems completely unrealistic. END COMMENT.)

17. (SBU) More importantly, investment in infrastructure is a crucial catalyst for growth over the next few years for the reconstruction and diversification of the Iraqi economy. Key infrastructure priorities are oil pipeline repair and development, electricity generation (\$5 billion for the GE and Siemens turbines), water, housing, agriculture, transportation, and communication. Deputy Prime Minister Rafe Al Issawi has estimated that a total of \$500 billion in investment is needed to reconstruct Iraq over time. Given budget realities, the GOI is exploring other means to jumpstart investment. Most prominently, the National Investment Commission is preparing a \$65 billion package of infrastructure upgrades that will be marketed to foreign investors, with the promise of payments from future oil revenues.

NEW IMF STANDBY ARRANGEMENT POSSIBLE

18. (SBU) A new Stand-By Arrangement (SBA) with the IMF may be the key for the GOI to pursue its capital improvements this year and next while also saving its reserves for possibly rockier years ahead. Central Bank of Iraq Governor Sinan al-Shabibi and Finance Minister Bayan Jabr met with IMF officials in June to discuss the terms of a possible \$5.5 billion, five-year standby loan that could be signed as early as October. This SBA may help the GOI through its budget

shortfall. The proposed terms would include GOI fiscal reforms, restructuring of state banks and the reform of the whole banking sector. Additional conditions call for currency stability and limiting the costly food rations program to only those who truly need it.

COMMENT

19. (SBU) The combined impact of higher oil prices and slow budget execution to date makes it likely that the GOI will meet its deficit target, although heavy pre-election spending could increase the pressure. With over \$20 billion in accumulated reserves at the end of 2008) split between the Development Fund for Iraq and GOI deposits in the Central Bank) Iraq should not have trouble financing this year's deficit. With an IMF agreement on the horizon, and at least some signing bonuses on oil contracts likely to be paid next year, the 2010 financing question is less dire than it appeared to be several months ago. The risk is that the reduced fiscal pressure will lead the GOI to make short-term policy decisions that have negative long-term consequences: indulging in a pre-election spending spree, deferring necessary infrastructure investments (including in capacity to facilitate increased oil exports), avoiding improvements in the investment climate and/or playing hardball with international oil companies such that Iraq doesn't get the benefit of foreign capital and expertise. Decisions made over the coming months will have a direct impact on Iraq's ability to finance its 2011 deficit, and on growth over the medium- and long-term. A new IMF SBA should help guide the GOI as it confronts its structural challenges, such as cutting basic operating expenses by ridding the payroll of ghost workers, closing loopholes for corruption, streamlining and privatizing state-owned enterprises, limiting unnecessary subsidies, and upgrading its technological base.

HILL